

No. 98-794

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# In the Supreme Court of the United States

OCTOBER TERM, 1998

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ESTATE OF BESSIE I. MUELLER, DECEASED, ET AL.,  
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

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*ON PETITION FOR A WRIT OF CERTIORARI  
TO THE UNITED STATES COURT OF APPEALS  
FOR THE SIXTH CIRCUIT*

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## **BRIEF FOR THE RESPONDENT IN OPPOSITION**

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**QUESTION PRESENTED**

Whether the Tax Court has authority to grant relief under the doctrine of equitable recoupment.

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### **OPINIONS BELOW**

The opinion of the court of appeals (Pet. App. 1a-12a) is reported at 153 F.3d 302. The opinion of the Tax Court on the issue of equitable recoupment (Pet. App. 13a-43a) is reported at 101 T.C. 551. Other opinions of the Tax Court in this case are reported at 63 T.C.M. (CCH) 3027 and 107 T.C. 189.

### **JURISDICTION**

The judgment of the court of appeals was entered on August 20, 1998. The petition for a writ of certiorari was filed on November 16, 1998. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

**STATEMENT**

1. Bessie I. Mueller died on March 24, 1986. Her estate, which is a petitioner in this case, filed a timely return that reported an estate tax liability of \$5,523,953. The gross estate included shares of Mueller Company stock valued at \$1505 per share. The Commissioner of Internal Revenue determined on audit that the Mueller Company stock should have been valued at \$2150 per share. As a result, even though the estate was entitled to a credit of \$1,152,649 that it had failed to claim for prior tax payments, the Internal Revenue Service determined that petitioners had underreported their estate tax liability (Pet. App. 4a-5a; C.A. App. 6).

Petitioners sought a redetermination of this estate tax liability in the Tax Court. After a trial, the court concluded that the Mueller Company stock had a value of \$1700 on the date of Mrs. Mueller's death. This valuation resulted in an estate tax deficiency that was smaller than the amount of the credit to which petitioners were entitled. The Tax Court therefore determined that petitioners had overpaid their estate taxes (Pet. App. 5a).

Under this valuation of the Mueller Company stock, petitioners had reported too large a capital gain (and too great an income tax liability) when they sold the stock after decedent's death. Petitioners had failed, however, to file a timely protective claim for refund of the income tax that they had paid. During the pendency of the Tax Court proceeding, petitioners instead filed an amended complaint alleging that, under the doctrine of equitable recoupment, the time-barred income tax overpayment should be offset against the asserted estate tax deficiency (Pet. App. 5a).

2. After the Tax Court entered its opinion on valuation, respondent moved to dismiss the claim based upon equitable recoupment for lack of jurisdiction. In a reviewed opinion, a divided Tax Court held that it had authority to entertain the affirmative defense of equitable recoupment (Pet. App. 13a-43a). In a subsequent opinion issued following further trial proceedings, the Tax Court held, by a twelve to five vote, that the doctrine of equitable recoupment was inapplicable upon the facts of this case. 107 T.C. 189 (1996).

3. The court of appeals affirmed the dismissal of the equitable recoupment claim. Relying on this Court's decision in *Commissioner v. Gooch Milling & Elevator Co.*, 320 U.S. 418 (1943), the court of appeals held that the Tax Court lacked jurisdiction to consider claims for equitable recoupment (Pet. App. 1a-12a).

### **ARGUMENT**

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. The court of appeals correctly held that the Tax Court lacks jurisdiction to consider a claim based upon the doctrine of equitable recoupment. The doctrine of equitable recoupment may provide relief from the effect of statutes of limitations by permitting a taxpayer, in certain limited circumstances, to set off ("recoup") a time-barred tax overpayment against an inconsistent tax liability timely asserted against him by respondent with respect to the same transaction. The doctrine of equitable recoupment is "in the nature of a defense arising out of some feature of the transaction upon which plaintiff's action is grounded." *Bull v. United States*, 295 U.S. 247, 262 (1935). "Recoupment

\* \* \* will permit the government to recoup a correctly assessed tax, which ordinarily could not be collected because of a statute of limitations bar, against a timely refund of a tax erroneously collected and conversely will permit a taxpayer to recoup an erroneously paid tax, the refund of which is time-barred, against a timely and correctly asserted deficiency by the government.” *O’Brien v. United States*, 766 F.2d 1038, 1049 (7th Cir. 1985). To be eligible for recoupment, the time-barred claim must stem from the same transaction that gave rise to the timely refund or deficiency claim. See *Rothensies v. Electric Storage Battery Co.*, 329 U.S. 296, 299 (1946); *O’Brien*, 766 F.2d at 1049.

As these authorities have made clear, a threshold requirement for equitable recoupment in a taxpayer’s favor is that there be a time-barred overpayment of tax to be “recouped” against the tax liability that is the subject of the timely suit. The Tax Court, however, is an Article I court that has only a limited statutory jurisdiction.<sup>1</sup> In particular, the jurisdiction of the Tax Court to determine tax overpayments and to redetermine deficiencies under Section 6512(b)(1) of the Code is expressly limited to determining overpayments of tax by the taxpayer of the tax *in respect of which the*

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<sup>1</sup> The jurisdiction of the Tax Court is defined in 26 U.S.C. 7442, which provides:

The Tax Court and its divisions shall have such jurisdiction as is conferred on them by this title, by chapters 1, 2 3, and 4 of the Internal Revenue Code of 1939, by title II and III of the Revenue Act of 1926 (44 Stat. 10-87), or by laws enacted subsequent to February 26, 1926.

The Tax Court has jurisdiction under 26 U.S.C. 6213(a) to redetermine deficiencies in income, estate, gift, and certain excise taxes that have been the subject of a notice of deficiency issued pursuant to 26 U.S.C. 6212.



*deficiency was determined.* 26 U.S.C. 6512(b)(1). The Tax Court has not been given jurisdiction to determine an overpayment of a tax that was not the subject of a notice of deficiency and a timely petition for redetermination. *Estate of Schneider v. Commissioner*, 93 T.C. 568, 570 (1989).

The Tax Court therefore had jurisdiction in this case to determine that petitioners had overpaid estate taxes—the tax in respect of which the Commissioner determined a deficiency. The income tax liability of the estate, however, was *not* the subject of a deficiency notice or of a timely petition to the Tax Court. Under 26 U.S.C. 6512(b)(1), the Tax Court therefore had no jurisdiction to determine whether petitioners overpaid the income tax on the gain resulting from the sale of Mueller Company stock.<sup>2</sup> Because the court had no jurisdiction to determine whether an overpayment of the income tax had occurred, it had no jurisdiction to apply the doctrine of equitable recoupment in determining the estate tax liability in this case.

More than fifty years ago, this Court reached precisely this same conclusion in holding, under the sub-

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<sup>2</sup> In certain circumstances, the Tax Court may consider *facts* pertaining to taxable years other than a year to which a petition for redetermination of a deficiency relates. Specifically, “[t]he Tax Court in redetermining a deficiency of income tax for any taxable year or of gift tax for any calendar year or calendar quarter shall consider such facts with relation to the taxes for other years or calendar quarters as may be necessary correctly to redetermine the amount of such deficiency, but *in so doing shall have no jurisdiction to determine whether or not the tax for any other year or calendar quarter has been overpaid or underpaid.*” 26 U.S.C. 6214(b) (emphasis added). The facts pertaining to other taxable *periods* might be relevant, for example, when the amount of the deficiency before the Tax Court is affected by the amount of carryovers from other taxable periods.

stantially identical predecessors of these statutes, that the predecessor of the Tax Court (the Board of Tax Appeals) lacked jurisdiction to consider equitable recoupment claims. *Commissioner v. Gooch Milling & Elevator Co.*, 320 U.S. 418 (1943). Because the Board was not a court “possessing general equity jurisdiction” and, in particular, lacked authority to determine overpayments of any tax “other than the one for which a deficiency has been assessed,” the Court concluded that the Board had no authority to consider “the plea of equitable recoupment” based upon such “other” taxes. *Id.* at 421-422. The Court explained its reasoning in detail (*id.* at 420-421 (footnotes omitted)):

The Commissioner assessed a deficiency only for the 1936 fiscal year and it was this assessment of which the respondent sought a review. The Board thus had jurisdiction to do no more than redetermine the 1936 deficiency distinct from any overpayment or underpayment in any prior or subsequent year. There was no occasion here for the Board to exercise its power under § 272(g) to consider any facts relating to the taxes for the 1935 fiscal year. The redetermination of the tax liability for the 1936 fiscal year was in no way dependent on any prior tax assessment or overpayment. Likewise, neither the fact that the prior overpayment could no longer be refunded nor the fact that the overpayment exceeded the amount of the deficiency had any relevance whatever to the redetermination of the correct tax for the 1936 fiscal year. The respondent, in other words, was seeking to have the 1935 overpayment used, not as an aid in redetermining the 1936 deficiency, but as an affirmative defense or offset to that deficiency.

This necessarily involved a determination of whether there was an overpayment during the 1935 fiscal year. The absolute and unequivocal language of the proviso of § 272(g), however, placed such a determination outside the jurisdiction of the Board. Thus to allow the Board to give effect to an equitable defense which of necessity is based upon a determination foreign to the Board's jurisdiction would be contrary to the expressed will of Congress.

Soon thereafter, the Court referred to its decision in *Gooch Milling* in noting that “we have held that the Tax Court has no jurisdiction to consider recoupment.” *Rothensies v. Electric Storage Battery Co.*, 329 U.S. at 303. Indeed, until its decision here, the Tax Court has also consistently held that it lacks jurisdiction to consider equitable recoupment. *Estate of Schneider v. Commissioner*, 93 T.C. 568 (1989); *Phillips Petroleum Co. v. Commissioner*, 92 T.C. 885 (1989); *Poinier v. Commissioner*, 86 T.C. 478, 490-491 (1986), aff'd in part and rev'd in part on other issues, 858 F.2d 917 (3d Cir. 1988), cert. denied, 490 U.S. 1019 (1989); *Estate of Van Winkle v. Commissioner*, 51 T.C. 994, 999-1000 (1969); *Vandenberge v. Commissioner*, 3 T.C. 321, 327-328 (1944), aff'd, 147 F.2d 167 (5th Cir.), cert. denied, 325 U.S. 875 (1945). The commentators have also agreed that the Tax Court lacks authority to consider equitable recoupment. *E.g.*, H. Dubroff, *The United States Tax Court—An Historical Analysis* 484-488 (1979); A. Andrews, *Modern-Day Equitable Recoupment and the “Two Tax Effect:” Avoidance of the Statutes of Limita-*

*tion in Federal Tax Controversies*, 28 Ariz. L. Rev. 595, 614 (1986).<sup>3</sup>

As the court of appeals correctly held (Pet. App. 10a), the reasoning and conclusion of *Gooch Milling* remain valid. “Until Congress deems it advisable to allow the [the Tax Court] to determine the overpayment or underpayment in any taxable year other than the one for which a deficiency has been assessed, the [Tax Court] must remain impotent when the plea of equitable recoupment is based upon an overpayment or underpayment in such other year.” 320 U.S. at 422.

2. Petitioners err in contending (Pet. 17–18) that the decision in *Gooch Milling* is ambiguous in its application to equitable recoupment claims. In *Gooch Milling*, the Court stated that the sole question before it was “[t]he jurisdiction of the Board of Tax Appeals to determine and apply a prior tax overpayment against a tax deficiency for a particular year” (320 U.S. at 418–419). Contrary to petitioners’ assertion (Pet. 17–18 & n.16), the Court was not confused in *Gooch Milling* as to whether it was addressing the applicability of equitable recoupment, as distinguished from setoff. The Court stated that the Board’s “want of jurisdiction to apply the doctrine of equitable recoupment in this case” was “manifest from [the applicable] statutory provisions” (320 U.S. at 420). See also *Rothensies v. Electric Storage Battery Co.*, 329 U.S. at 303 (noting *Gooch Milling* holds “that the Tax Court has no jurisdiction to consider recoupment”).

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<sup>3</sup> Nothing in the legislation that made the Tax Court an Article I legislative court (Tax Reform Act of 1969, Pub. L. No. 91-172, §§ 951-962, 83 Stat. 730-736) alters this analysis or affects this conclusion. See *Continental Equities, Inc. v. Commissioner*, 551 F.2d 74, 82-84 (5th Cir. 1977).

3. a. Petitioners also are incorrect in contending (Pet. 18-21) that *Gooch Milling* has been “superceded” by the decision in *United States v. Dalm*, 494 U.S. 596 (1990). *Dalm* provides no support for the proposition that the Tax Court has authority to grant equitable recoupment. The *Dalm* case addressed the unrelated question whether “the doctrine of equitable recoupment supports a separate suit for refund” of a time-barred gift tax when the taxpayer had settled a Tax Court deficiency proceeding in which the transferred property was treated as an item of income by agreeing “to pay income tax on the transaction.” *Id.* at 598. The Court held in *Dalm* that the doctrine of equitable recoupment did not provide an independent basis for jurisdiction in the district court over the time-barred refund claim of the gift tax payment. *Id.* at 611.

The Court noted in *Dalm* that the taxpayer in that case had not attempted to raise a recoupment claim in the prior Tax Court proceeding. The Court emphasized that “[w]e have no occasion to pass upon the question whether Dalm could have raised a recoupment claim in the Tax Court.” 494 U.S. at 611 & n.8. The decision in *Dalm* thus plainly does not address, much less purport to alter, the longstanding determination of this Court in *Gooch Milling* and *Rothensies* that the Tax Court lacks jurisdiction over equitable recoupment claims.

b. Petitioners, however, do not rely on *Dalm* for what it actually held. Instead, they note that in *Dalm* the Court stated that a district court lacks jurisdiction to adjudicate a claim for recoupment of a time-barred overpayment when it does not have jurisdiction over the tax claim against which equitable recoupment might properly be had. 494 U.S. at 611. Petitioners assert (Pet. 20) that *Dalm* therefore supports the proposition that, if *any* court has jurisdiction over the

tax claim against which equitable recoupment might properly be had, then it would also have jurisdiction over the time-barred recoupment claim.

While it is certainly true under *Dalm* that a *district court* that has jurisdiction over what petitioners refer to as the “main action” (Pet. 20) has authority to adjudicate the recoupment claim as well (see 494 U.S. at 611), it does not follow that the *Tax Court* has authority to decide a recoupment claim merely because it has jurisdiction over the “main action.” To the contrary, as the Court held in *Gooch Milling*, due to the specific limitations that Congress has placed upon its jurisdiction, the Tax Court lacks authority to decide equitable recoupment claims, even when it has jurisdiction over the “main action.”

#### CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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JANUARY 1999